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COMMONWEALTH OF VIRGINIA

STATE CORPORATION COMMISSION

AT RICHMOND, AUGUST 24, 1999

COMMONWEALTH OF VIRGINIA, ex rel.

STATE CORPORATION COMMISSION

Ex Parte: In the matter of
Adopting Revisions to the Rules
Governing Annual Audited
Financial Reports

CASE NO. INS990202

ORDER TO TAKE NOTICE

WHEREAS, § 12.1-13 of the Code of Virginia provides that the Commission shall have the power to promulgate rules and regulations in the enforcement and administration of all laws within its jurisdiction, and § 38.2-223 of the Code of Virginia provides that the Commission may issue any rules and regulations necessary or appropriate for the administration and enforcement of Title 38.2 of the Code of Virginia;

WHEREAS, the rules and regulations issued by the Commission pursuant to § 38.2-223 of the Code of Virginia are set forth in Title 14 of the Virginia Administrative Code;

WHEREAS, the Bureau of Insurance has submitted to the Commission proposed revisions to Chapter 270 of Title 14 of the Virginia Administrative Code entitled "Rules Governing Annual Audited Financial Reports," which amend the rules at 14 VAC 5-

270-30, 14 VAC 5-270-40, 14 VAC 5-270-60 through 14 VAC 5-270-80, and 14 VAC 5-270-160; and

WHEREAS, the Commission is of the opinion that the proposed revisions should be adopted with an effective date of January 1, 2000;

THEREFORE, IT IS ORDERED THAT:

(1) All interested persons TAKE NOTICE that the Commission shall enter an order subsequent to October 22, 1999, adopting the revisions proposed by the Bureau of Insurance unless on or before October 22, 1999, any person objecting to the proposed revisions files a request for a hearing to oppose the adoption of the proposed revisions, with an effective date of January 1, 2000, with the Clerk of the Commission, Document Control Center, P.O. Box 2118, Richmond, Virginia 23218;

(2) All interested persons TAKE NOTICE that on or before October 22, 1999, any person desiring to comment in support of, or in opposition to, the proposed revisions shall file such comments in writing with the Clerk of the Commission at the above address;

(3) The proposed revisions to the "Rules Governing Annual Audited Financial Reports," which amend 14 VAC 5-270-30, 14 VAC 5-270-40, 14 VAC 5-270-60 through 14 VAC 5-270-80, and 14 VAC 5-270-160, be attached hereto and made a part hereof;

(4) All filings made under paragraphs (1) or (2) above shall contain a reference to Case No. INS990202;

(5) An attested copy hereof, together with a copy of the proposed revisions, be sent by the Clerk of the Commission to the Bureau of Insurance in care of Deputy Commissioner Douglas C. Stolte, who forthwith shall give further notice of the proposed adoption of the revisions to the rules by mailing a copy of this order, together with a draft of the proposed revisions, to all insurers, burial societies, fraternal benefit societies, health services plans, health maintenance organizations, legal services plans, and dental or optometric services plans licensed by the Commission; and

(6) The Bureau of Insurance shall file with the Clerk of the Commission an affidavit of compliance with the notice requirements of paragraph (5) above.

RULES GOVERNING ANNUAL AUDITED FINANCIAL REPORTS

14 VAC 5-270-30. Scope.

This chapter (14 VAC 5-270-10 et seq.) shall apply to all organizations listed in 14 VAC 5-270-20, hereinafter referred to as "insurers." Insurers having direct premiums written of less than ~~\$1,000,000~~ \$1 million in any calendar year and having less than 1,000 policyholders or certificate holders of directly written policies at the end of such calendar year are exempt from the requirements of this chapter for such year unless the Commission deems that compliance with the reporting requirements of this chapter is necessary to establish the financial condition of an insurer. Insurers having assumed premiums of ~~\$1,000,000~~ \$1 million or more pursuant to contracts and/or treaties of reinsurance will not be so exempt.

Foreign or alien insurers filing Audited Financial Reports in another state, pursuant to that state's requirements for filing of Audited Financial Reports and where such requirements have been found by the Commission to be substantially similar to the requirements herein, are exempt from this chapter if:

1. Copies of the Audited Financial Report, the Report on Significant Deficiencies in Internal Controls, and the Accountant's Letter of Qualifications which are filed with such other state are filed with the Commission in accordance with the filing dates specified in 14 VAC 5-270-50, 14 VAC 5-270-120, and 14 VAC 5-270-130, respectively, (Canadian insurers may submit Accountants' reports as filed with the Canadian ~~Dominion Department of Insurance~~ Office of the Superintendent of Financial Institutions); and

2. A copy of any Notification of Adverse Financial Condition Report filed with such other state is filed with the Commission within the time specified in 14 VAC 5-270-110.

This provision shall not prohibit, preclude or in any way limit the Commission's rights with respect to workpapers described in 14 VAC 5-270-140 of this chapter or its rights concerning the ordering and/or conducting and/or performing of examinations of insurers under Title 38.2 of the ~~Virginia~~ Code of Virginia.

RULES GOVERNING ANNUAL AUDITED FINANCIAL REPORTS

14 VAC 5-270-40. Definitions.

As used in this chapter:

~~"Audited Financial Report" means and includes those items specified in 14 VAC 5-270-60 of this chapter.~~

"Accountant" and "Independent Certified Public Accountant" ~~means~~ mean an independent, certified public accountant or accounting firm in good standing with the American Institute of Certified Public Accountants ("AICPA") and in all states in which such accountant or firm is licensed to practice; for Canadian and British companies, ~~it means~~ they mean a Canadian-chartered or British-chartered accountant.

"Audited Financial Report" means and includes those items specified in 14 VAC 5-270-60 of this chapter.

"Commission" means the State Corporation Commission when acting pursuant to or in accordance with Title 38.2 of the Code of Virginia.

"Due date" means (i) June 1 for all domestic insurers, and (ii) June 30 for all foreign or alien companies domiciled or entered through a state in which similar law, regulation or administrative practice provides for a June 30 filing date, or (iii), for all other insurers, the earlier of June 30 or the date established by the insurer's state of domicile or entry for filing similar audited financial reports.

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"Workpapers" means the records kept by the Accountant of the procedures followed, the tests performed, the information obtained, and the conclusions reached pertinent to the Accountant's examination of the financial statements of an insurer. Workpapers, accordingly, may include work programs, analyses, memoranda, letters of confirmation and representation, abstracts of company documents, and schedules or commentaries prepared or obtained by the Accountant in the course of the examination of the financial statements of an insurer and which support the Accountant's opinion thereof.

14 VAC 5-270-60. Contents of annual Audited Financial Report.

The annual Audited Financial Report shall report the financial position of the insurer as of the end of the most recent calendar year and the results of its operations, cash flows, and changes in capital and surplus for the year then ended in conformity with statutory accounting practices prescribed, or otherwise permitted, by the insurer's state of domicile. The annual Audited Financial Report shall include the following:

1. Report of Independent Certified Public Accountant.
2. Balance sheet reporting admitted assets, liabilities, capital, and surplus.
3. Statement of operations.
4. Statement of cash flows.
5. Statement of changes in capital and surplus.

6. Notes to financial statements. These notes shall be those required by the appropriate Annual Statement and/or generally accepted accounting principles and shall also include: and NAIC accounting practices and procedures manual. The notes shall include a reconciliation of differences, if any, between the audited statutory financial statements and the Annual Statement filed pursuant to §§ 38.2-1300, 38.2-4126 or 38.2-4307 of the Code of Virginia with a written description of the nature of these differences.

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~~a. A reconciliation of differences, if any, between the statutory financial statements contained in the Audited Financial Report and the Annual Statement filed pursuant to §§ 38.2-1300, 38.2-4126 or 38.2-4307 of the Virginia Insurance Code with a written description of the nature of these differences.~~

~~b. A summary of ownership and relationships of the insurer and all affiliated companies.~~

7. The financial statements included in the Audited Financial Report shall be prepared in a form and using language and groupings substantially the same as the relevant sections of the Annual Statement the insurer filed with the Commission and the financial statements shall be comparative, presenting the amounts as of December 31 of the current year and the amounts as of the immediately preceding December 31. (However, in the first year in which an insurer is required to file an Audited Financial Report, the comparative data may be omitted.)

14 VAC 5-270-70. Designation of Independent Certified Public Accountant.

Each insurer required by this chapter to file an annual Audited Financial Report must within 60 days after becoming subject to such requirement, register with the Commission in writing the name and address of the Accountant retained to conduct the annual audit set forth in this chapter. ~~Insurers not retaining an Accountant on September 1, 1991 shall register the name and address of a retained Accountant within six months after September 1, 1991.~~

As part of this registration, the insurer shall obtain a letter from the Accountant and file a copy with the Commission stating that the Accountant is aware of the provisions of the Insurance Code and the rules and regulations of the Insurance Department of the state of domicile that relate to accounting and financial matters, and affirming that he will express his opinion on the financial statements in the terms of their conformity to the statutory accounting practices prescribed or

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otherwise permitted by that Department, specifying such exceptions as he may believe appropriate.

If the Accountant who was the Accountant for the immediately preceding filed Audited Financial Report is dismissed or resigns, the insurer shall ~~within five business days~~ notify the Commission within five business days of this event. The insurer also shall ~~also~~ furnish the Commission with a separate letter within 10 business days of the above notification stating whether in the 24 months preceding such event there were any disagreements with the former Accountant on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure; which disagreements, if not resolved to the satisfaction of the former Accountant, would have caused him to make reference to the subject matter of the disagreement in his opinion. The disagreements required to be reported in response to this section include those resolved to the former Accountant's satisfaction and those not resolved to the former Accountant's satisfaction. Disagreements contemplated by this section are those that occur at the decision-making level, i.e., between personnel of the insurer responsible for presentation of its financial statements and personnel of the accounting firm responsible for rendering its report. The insurer ~~shall~~ also in writing shall request such former Accountant to furnish a letter addressed to the insurer stating whether the Accountant agrees with the statements contained in the insurer's letter and, if not, stating the reasons for disagreement; and the insurer shall furnish such responsive letter from the former Accountant to the Commission together with its own letter.

14 VAC 5-270-80. Qualifications of accountant.

A. The Commission shall not recognize any person or firm as a qualified Accountant that is not in good standing with the AICPA and in all states in which the Accountant is licensed to practice, or, for a Canadian or British company, that is not a chartered Accountant.

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B. Except as otherwise provided herein, an Independent Certified Public Accountant shall be recognized as qualified as long as he or she conforms to the standards of his or her profession, as contained in the Code of Professional Conduct of the AICPA and the Rules and Regulations, including the Standards of Practice, of the Virginia Board for Accountancy, or similar code.

C. No partner or other person responsible for rendering a report may act in that capacity for more than seven consecutive years. Following any period of service, such person shall be disqualified from acting in that or a similar capacity for the same company or its insurance subsidiaries or affiliates for a period of two years. An insurer may make application to the Commission for relief from the above rotation requirement on the basis of unusual circumstances. The Commission may consider the following factors in determining if the relief should be granted:

1. Number of partners, expertise of the partners or the number of insurance clients in the currently registered firm;
2. Premium volume of the insurer; or
3. Number of jurisdictions in which the insurer transacts business.

~~The requirements of this subsection shall become effective two years after the promulgation of this chapter.~~

D. The Commission shall not recognize as a qualified Accountant, nor accept any annual Audited Financial Report, prepared in whole or in part by, any person who:

1. Has been convicted of fraud, bribery, a violation of the Racketeer Influenced and Corrupt Organizations Act (18 USC §§1961-1968) or any dishonest conduct or practices under federal or state law;
2. Has violated the insurance laws of this Commonwealth with respect to any previous reports submitted under this chapter; or
3. Has demonstrated a pattern or practice of failing to detect or disclose material information in previous reports filed under the provisions of this chapter.

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E. The Commission may (i) make a determination as to whether an Accountant is qualified and may, based upon the facts considered, determine that such Accountant is not qualified for purposes of expressing an opinion on the financial statements in the annual Audited Financial Report made pursuant to this chapter and (ii) require the insurer to replace such Accountant with another whose relationship with the insurer is qualified within the meaning of this chapter.

~~14 VAC 5-270-160. Effective dates.~~

~~All insurers retaining a certified public accountant on September 1, 1991 who qualifies as an Accountant shall comply with all provisions of this chapter for the year ending December 31, 1991, and each year thereafter unless the Commission permits otherwise.~~

~~Insurers not retaining a certified public accountant on September 1, 1991 who qualifies as independent may meet the following schedule for compliance unless the Commission permits otherwise:~~

- ~~1. For the year ending December 31, 1991, file with the Commission:~~
 - ~~a. Report of Independent Certified Public Accountant;~~
 - ~~b. Audited balance sheet; and~~
 - ~~c. Notes to audited balance sheet.~~
- ~~2. For the year ending December 31, 1992, and each year thereafter, such insurers shall file with the Commission all reports required by this chapter.~~